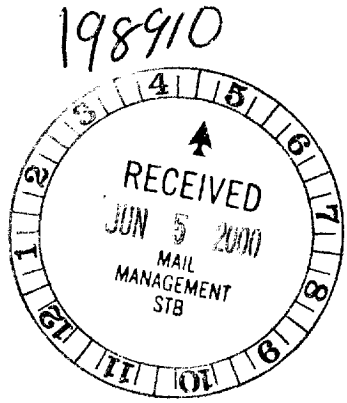
198910

THOMPSON
HINE & FLORY LLP

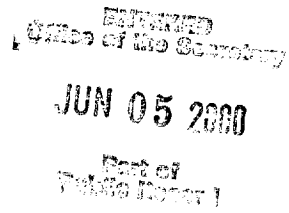
Attorneys at Law



June 5, 2000

Via Hand Delivery

The Honorable Vernon A. Williams
Secretary
Office of the Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001



ATTN: STB Ex Parte No. 582 (Sub-No.1)

Re: STB Ex Parte No. 582 (Sub-No.1); *Major Rail Consolidation Procedures*

Dear Secretary Williams:

Please find enclosed for filing in the above-referenced docket an executed original and twenty-five (25) copies of the Reply Comments filed on behalf of The National Industrial Transportation League. An extra copy of this filing is enclosed for stamping and return to our office. Also enclosed is a diskette compatible to WordPerfect 7.0 with a copy of the Reply Comments.

Should you have any questions concerning this filing, please do not hesitate to contact the undersigned. Thank you for your cooperation and assistance in this matter.

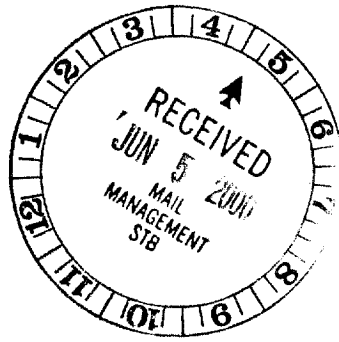
Respectfully submitted,

NICHOLAS J. DIMICHAEL

Enclosures

198918

BEFORE THE
SURFACE TRANSPORTATION BOARD



STB Ex Parte 582 (Sub-No. 1)

Major Rail Consolidation Procedures

REPLY COMMENTS

Submitted by

The National Industrial Transportation League

The National Industrial Transportation League ("League") respectfully submits these Reply Comments to the Surface Transportation Board ("STB"), as permitted by the Board's Advance Notice of Proposed Rulemaking ("ANPR") issued on March 31, 2000. On May 16, the League submitted extensive comments to the Board in this case. Since then, it has reviewed the Comments submitted by other parties, and desires to make a few additional comments to the Board in response.

I. A Re-Examination of the Presumption Created by the Board's Use of the "One Lump" Theory Is Necessary for a Rational Revision of the Board's Merger Rules and Its Approach to Rail-to-Rail Competition in Future Rail Mergers

A number of the major Class I railroads object to the Board's proposal to reconsider its application of the "one lump" theory in rail mergers. See, *e.g.*, UP Comments at 15; NS Comments at 50-51; BNSF Comments at 27; CSX Comments at 22. The League strongly

believes that the Board must reconsider its approach to the "one lump" theory as a necessary predicate to a rational reexamination of its merger rules.

In its Comments filed on May 16, the League traced the genesis and development of the "one-lump" theory, and how the Board's uncritical use of that theory has led it to the conclusion that there are few, if any, anticompetitive effects in end-to-end mergers. See, NITL Comments, pp. 5-9. But, as the League argued in its Comments, this conclusion is simply wrong. The League urged the Board to immediately overrule the presumption currently created by its adoption of the "one lump" theory in past cases. If applicant carriers in future mergers believe that a particular vertical merger will not eliminate downstream competition, they should be required to submit actual evidence showing that in past mergers, the price to "downstream" shippers has not been affected when the downstream and upstream carriers merge. Secondly, the League urged the Board to initiate a study of the downstream effects of prior rail mergers, so that there is a substantial factual basis for any consideration of downstream effects in future cases.

If the Board is to re-examine its merger rules so as to become much more sensitive to the multiple hues of competition, the Board must reexamine its approach to the "one lump" theory. Without such a re-examination, the Board will be utterly unable to do anything about the anti-competitive effect of future mergers. Because of its adoption of the "one lump" theory, the Board has, in effect, already concluded that, absent some extraordinary showing by broad numbers of shippers participating in a future rail merger proceeding, there is no anticompetitive effect to any future foreseeable rail merger, and thus no basis for denying or conditioning a future merger application. This is because, given the current consolidated state of the rail industry, there will in all likelihood only be end-to-end rail mergers (down to two rail carriers) in the future; and the only anticompetitive effects of such end-to-end mergers will be excused by

the Board's prior approach to the "one lump" theory. Even if the Board were to conclude that end-to-end mergers hold few benefits, the fact of the matter is that future rail merger applicants will be able to show some benefits to the public as a result of their proposed transaction, and if these benefits are not counterbalanced by cognizable anticompetitive effects, there will be little basis under the statute for denying or even conditioning a future rail merger application.

Beyond the League's comments and the comments of a number of other parties regarding the need for the Board to review the "one lump" theory, see, *e.g.,* the Comments of The Dow Chemical Company, which reported on its experience after the UP/SP merger, pp. 3-4, there is a clear basis in the record in this proceeding in the comments of the major railroads themselves for a reexamination of that theory. A number of the major Class I railroads themselves propose that the Board should condition future mergers to maintain open gateways, or to preserve the Board's "contract exception" to its bottleneck rules. See, *e.g.,* CN Comments at 31; UP Comments at 11-14; NS Comments at 34-39, 51. However, even the railroads' own narrowly-drawn proposals are flatly inconsistent with the conclusions of the "one lump" theory. Specifically, the basis for the railroads' own proposals regarding open gateways and bottleneck rates, is a recognition that when the merger of an upstream bottleneck carrier with the "neutral" downstream carrier results in the consolidated carrier's obtaining single line service from origin to destination, the transaction results in a loss of competition between the pre-merger connecting carriers. Under the railroads' various proposals, "the pre-merger competition between such connecting railroads would be preserved." NS Comments at 51. But this assumes that there truly is pre-merger competition between the two carriers on the downstream leg; that the effect of this competition flows through to the shipper; that this competition benefits the shipper on the downstream leg;

and that this competition will be eliminated by the merger of the upstream and downstream carriers.

However, under the one lump theory, it is presumed that, even if there is pre-merger competition between downstream carriers, the shipper is not harmed by the merger of the upstream and downstream carrier, because the upstream "bottleneck" carrier would have already "soaked up" all of the possible monopoly rents, and therefore the shipper is no worse off if the upstream and downstream carriers merge, thus eliminating whatever competition there was from the other downstream carrier. But a requirement that merger applicants keep gateways open, or that merger applicants provide bottleneck rates that can be discretely challenged for reasonableness (as several of the major Class I railroads propose, as cited above), simply cannot co-exist with the Board's approach to the "one lump" theory. This is because, on the one hand, these proposals presume that shippers do benefit from pre-merger competition from downstream competing carriers and that the merger of an upstream and downstream carrier results in some competitive harm to the shipper, while on the other hand, the "one lump" theory presumes precisely the opposite. Indeed, if the Board were to act to keep gateways open without a reconsideration of its one lump theory, the Board's decision could be open to challenge on judicial review.

The League, then, again strongly urges the Board to re-examine its approach to the "one lump" theory as discussed in the League's opening Comments.

II. The Board Should Give Significant Weight to the Proposals of the Department of Transportation, Which Agree With the League's Comments in Many Respects, and In Particular to DOT's Comments With Respect to Reciprocal Switching and Bottlenecks

In extensive Comments filed on May 16, the Department of Transportation ("DOT") discussed numerous service, safety and competitive issues. DOT proposed, *inter alia*, that: (1)

the Board should require more extensive quantification of the public benefits of major rail combinations, and a more detailed accounting of the investment and operational steps that the applicants will take to ensure that the benefits are realized and the risks avoided; (2) the Board should continue with the existing process of Safety Implementation Plans and its emphasis on rail safety; (3) the Board should act to maintain major gateways, provide for expanded reciprocal switching at terminals, and remove procedural hurdles for implementing relief under the "bottleneck" decision; (4) the Board should adopt procedures to mitigate the possibility of service problems flowing from a rail merger, and provide for recovery of damages suffered by shippers affected by rail service failures; (5) the Board should broadly explore cross-border effects of a proposed rail merger; and, (6) the Board was correct in proposing elimination of the "one case at a time" rule.

Many of DOT's proposals are very similar to the comments submitted by the League. Compare, League and DOT discussion of: merger benefits and implementation (DOT Comments at 35-36; League Comments at 9-10); safety (DOT Comments at 4-5; League Comments at 21); gateways, reciprocal switching and bottlenecks (DOT Comments at 13-16; League Comments at 13-17); rail service problems (DOT Comments at 6-9, 12; League Comments at 19-20); cross-border effects (DOT Comments at 31-35; League Comments at 21-22); and, the one case at a time rule (DOT Comments at 36; League Comments at 5). The Board, the League believes, should take particular note of the comments submitted by a federal agency with such expertise and involvement in rail matters.

In particular, the League would urge the Board to closely consider DOT's discussion of competition issues. For many years, the rail industry has maintained that the provision of additional rail-to-rail competition would be "reregulation" and would lead to the financial ruin of

the industry. Indeed, the very generalized comments of the Association of American Railroads ("AAR") still sing this same sad song. See, AAR Comments, pp. 8-9. But DOT's Comments in this proceeding are flatly inconsistent with AAR's self-serving view. As the League has noted many times before, shippers want and need a financially healthy rail industry. Increasing rail to rail competition is not inconsistent with this view, but on the contrary would lead to a more efficient, innovative, and customer-focused industry. As it stated in its Comments, the League believes that increasing rail-to-rail competition should be done on an industry-wide basis. See, League Comments, p. 12; *see also*, BNSF Comments, at 24.

Clearly, DOT also wants a financially healthy rail industry: indeed, as the guardian of safety on the nation's railroads, one would expect DOT to be particularly sensitive to the financial needs of the nation's rail carriers, since rail safety costs money, and the industry must be financially healthy if it is to be safe. Yet, in its comments submitted on May 16, DOT clearly also believes that increasing rail to rail competition is consistent with rail carriers' financial needs, and that increasing such competition would not lead to financial ruin.[1] The Board should carefully consider DOT's views, and the views of the many other parties who have also called in this proceeding for an increase in rail-to-rail competition, as it develops revised merger rules.

---

[1] DOT's Comments cite to a study by John Bitzan, *Railroad Cost Considerations – Implications for Policy*, Upper Great Lakes Transportation Institute, North Dakota State University, May 10, 2000, for the proposition that there are few or no economies that can be realized from end-to-end mergers. DOT Comments, p. 13. However, a number of conclusions of that study, which do not appear to be shared by DOT, appear to be highly contestable, such as the author's conclusion that maintaining competition in markets impacted by parallel mergers is not justified by railroad cost considerations (Bitzan, p. 115) (a conclusion at odds with the Board's policy and comments from a number of parties in this case), or that introducing railroad competition would not be beneficial from a cost perspective (*id.*). Indeed, on this record the latter conclusion is specifically rebutted by a study by Professor Robert E. McCormick, Professor of Economics, Clemson University, submitted as part of the Comments of the American Plastics Council and the Chemical Manufacturers Association. See, McCormick Verified Statement, summary at pp. 42-43.

III. The Analysis of the Kansas City Southern Railway Company With Respect to "3-to-2 Issues" Deserve the Board's Consideration

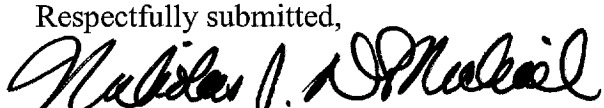
In its Comments, the League noted that competition from three rail carriers is superior to that of only two carriers, but that a formal re-examination of the Board's policy regarding its approach to so-called "3-to-2" issues is probably not meaningful at the present time, given the current consolidated state of the rail industry.

After reviewing the comments of the parties to this proceeding, however, the League would like to note the comments of the Kansas City Southern Railway ("KSC") in this regard. KCS points out that there are some limited markets that are still served by three carriers over particular routes. While the League does not believe in, and would not support, a *per se* rule that would absolutely prevent any rail mergers in such markets, the League does believe that, if a given market is served by three rail carriers, the Board should very carefully evaluate the competitive condition of the rail industry in those markets, to insure that the intensity of competition is fully preserved. Moreover, the Board's reconsideration of the "one case at a time" rule would be consistent with such a reexamination of "3-to-2" situations. When a point is effectively served by three rail carriers, but through a merger rail service is reduced to two carriers, a subsequent merger could further reduce competition at that point to only a single carrier. In that case, the Board would likely impose trackage rights to preserve pre-merger (*i.e.*, "2-to-1") competition. But trackage rights can never be a perfect substitute for rail ownership and control. Thus, an increased sensitivity to "3-to-2" situations could preserve vigorous competition in at least the few remaining rail markets that are served by three rail carriers, to prevent eventual "3-to-1" situations.

IV. Conclusion

The League respectfully requests the Board to consider the Reply Comments submitted above, and its extensive initial Comments submitted in this proceeding on May 16, 2000.

Respectfully submitted,



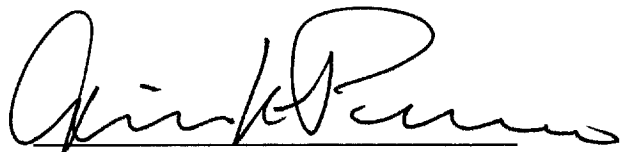
Nicholas J. DiMichael
Thompson Hine & Flory LLP
1920 N. St. N.W.
Suite 800
Washington, D.C. 20036

Attorney for the National Industrial Transportation League

Due and dated: June 5, 2000

CERTIFICATE OF SERVICE

I hereby certify that I have served on this 5th day of June, 2000 a copy of the above Reply Comments of The National Industrial Transportation League by first class mail postage pre-paid, to all parties of record.



Aimee DePew